Supreme Court, U.S.
FILED
OCT 11 1994
OFFICE OF THE CLERK

Nos. 93-1612 and 93-1613

In the Supreme Court of the United States

OCTOBER TERM, 1994

NATIONSBANK OF NORTH CAROLINA, N.A., ET AL., PETITIONERS

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL.

EUGENE LUDWIG, COMPTROLLER OF THE CURRENCY, ET AL., PETITIONERS

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL PETITIONERS

DREW S. DAYS, III
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

TABLE OF AUTHORITIES

Cases:	Page
Barnett Bank of Marion County, N.A. v. *Gallagher*, 839 F. Supp. 835 (M.D. Fla. 1993), appeal pending, No. 93-3508 (11th Cir.)	6
Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)	7, 10
Clarke v. *Securities Indus. Ass'n*, 479 U.S. 388 (1987)	8
New York State Ass'n of Life Underwriters, Inc. v. *New York State Banking Dep't*, 632 N.E.2d 876 (N.Y. 1994)	3
Owensboro Nat'l Bank v. *Moore*, 803 F. Supp. 24 (E.D. Ky. 1992), appeals pending *sub nom. The Owensboro Nat'l Bank* v. *Stephens*, Nos. 92-6330 & 92-6331 (6th Cir.)	6
SEC v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943)	4
SEC v. *United Benefit Life Ins. Co.*, 387 U.S. 202 (1967)	4, 9
SEC v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959)	9
Securities Indus. Ass'n v. *Board of Governors*, 468 U.S. 207 (1984)	8

Statutes:	
12 U.S.C. 24 Seventh (1988 & Supp. V 1993)	2, 3, 7
12 U.S.C. 92 (Supp. V 1993)	1, 2, 3, 6

Miscellaneous:	
B. Hammond, *Sovereignty and An Empty Purse: Banks and Politics in the Civil War* (1970)	8
4 L. Loss, *Securities Regulation* (Supp. ed. 1969)	6
D. Shapiro & T. Streiff, *Annuities* (1992)	5

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 93-1612

NATIONSBANK OF NORTH CAROLINA, N.A., ET AL., PETITIONERS

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL.

No. 93-1613

EUGENE LUDWIG, COMPTROLLER OF THE CURRENCY, ET AL., PETITIONERS

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL PETITIONERS

Respondent argues (Br. 11-16) that 12 U.S.C. 92 (Supp. V 1993) prohibits national banks outside small towns from selling any sort of "insurance," no matter how closely such sales may relate to the banks' other business. The bulk of respondent's brief (Br. 16-35) then

offers an historical discussion of whether annuities are or are not "insurance." Finally, respondent challenges (Br. 35-49) the Comptroller's conclusion that the sales of annuities proposed by petitioner NationsBank in this case are authorized under the general banking powers statute, 12 U.S.C. 24 Seventh (1988 & Supp. V 1993). These arguments are inconsistent with the language of the statutes involved and the reasonable interpretation of those statutes by the Comptroller.

1. As we explained in our opening brief (at 39-42), Section 92 is a grant of supplemental powers to national banks that operate in small towns, not a restriction on the powers that are conferred on all national banks by other statutory provisions. Respondent argues (Br. 15-16) that the Comptroller must "redraft" Section 92 in order to arrive at that interpretation. To the contrary, the Comptroller's construction follows directly from the language of the statute, which provides that *"[i]n addition to* the powers now vested by law" in all national banks, banks located in small towns "may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company." 12 U.S.C. 92 (emphasis added). Respondent, on the other hand, avoids the language of the statute by asserting that Section 92 "bars national banks from acting as agent for 'any' insurance company in the sale of 'insurance.'" Br. 15. Section 92 does not "bar" anyone from doing anything; it is respondent's paraphrase that "redrafts" the statute's language.

Respondent defends its construction of Section 92 by invoking the maxim "*expressio unius est exclusio alterius*." See Br. 11-15. That principle is inapposite here. The general banking powers statute, 12 U.S.C. 24 Seventh, permits national banks to engage in all

activities that are part of or incidental to the "business of banking." Section 92 provides that "[i]n addition," small-town banks may operate general insurance agencies. Respondent argues that because Section 92 affirmatively authorizes national banks in small towns to engage in that activity, Section 24 Seventh cannot independently authorize the sale of any "insurance" product, even when such sales are part of or incidental to the business of banking. That argument is illogical. There is no reason why sales of insurance cannot be authorized by both statutory provisions. The role of Section 92 is not to prohibit national banks generally from acting as agents in the sale of insurance, but to provide that banks in small towns *may* sell fire, life, or other insurance, even when those sales are not otherwise incidental to banking.

2. Respondent devotes the bulk of its submission (Br. 16-35) to a largely historical discussion of whether "annuities" in general are or are not "insurance." Because Section 92 imposes no limitation on bank sales of "insurance" products when such sales are part of or incidental to the business of banking, it is not necessary to resolve that question in the abstract—even though, as our opening submission made clear (at 34-35), "the great weight of authority supports the position that annuities are *not* insurance." *New York State Ass'n of Life Underwriters, Inc.* v. *New York State Banking Dep't*, 632 N.E.2d 876, 881 (N.Y. 1994) (emphasis added). The controlling question in this case is, instead, whether the Comptroller could permissibly conclude that agency sales of annuities of the sort that petitioner NationsBank seeks to market are functionally part of or incidental to the business of banking.

The sort of inquiry appropriate to the resolution of that question is well illustrated by the discussion of

annuities, investment products, and "insurance" in the Comptroller's decision in this case, as well the discussion in our opening brief. See 93-1612 Pet. App. 37a-47a; Gov't Br. 25-38. Those discussions demonstrate that the Comptroller was justified in concluding that in marketing contemporary annuity products in accordance with its proposal, NationsBank would be filling the traditional role of national banks as intermediaries in the purchase and sale of financial investments by bank customers, not setting itself up as a general insurance agency of the sort that Section 92 permits small-town banks to operate.[1]

Respondent does not succeed in impeaching the Comptroller's determination. Much of respondent's general discussion of "annuities" (Br. 18-25), for example, assumes without elaboration that the annuity products in question in this case are of the most traditional type, in which the purchaser must or is expected to take his payout in periodic payments guaranteed to continue throughout his life. As we pointed out in our opening brief (at 32-34), however, such

[1] In exploring the issue of how contemporary annuity products should be characterized for purposes of contemporary bank regulation, we think that a practical modern text "written by two financial planners and * * * intended primarily to provide 'information on how to position and market annuities'" (Resp. Br. 28 n.12) is a more valuable reference than cases and treatises from the nineteenth and early twentieth centuries. See, *e.g.*, *id.* at 22-23, 25-30. As this Court has remarked in the securities context, "it is not inappropriate that promoters' offerings be judged as being what they were represented to be." *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967) (quoting *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 353 (1943)).

annuities do not dominate the modern marketplace.[2] Respondent also points out (Br. 26-28) that several variations on the annuity theme have been known for some time, without seriously contesting our primary assertion that today's annuity purchaser is typically an individual seeking tax-deferred accumulation of capital for retirement (primarily an investment objective), rather than an older investor or trustee accepting a lower rate of return in order to obtain a guaranty of lifetime payment (which might be characterized as the purchase of a sort of "longevity insurance"). Finally, respondent argues (Br. 29-30) that many States regulate annuity contracts and their issuers under their insurance laws. Under the Comptroller's approval, however, NationsBank would not be issuing annuities (the primary concern of such state regulation), and it would

[2] Respondent says (Br. 32) that statistics we offered in partial support of this point are "misleading," but it fails to explain how. Moreover, respondent characterizes our data as "designed to imply that fixed annuities are a trivial portion of the market." *Ibid.*; In fact, the passage that respondent cites (Gov't Br. 33-34 & n.16) primarily contrasts not fixed and variable annuities, but fixed annuities in different phases (accumulation or payout) and with different types of payout provisions (and thus different degrees of mortality risk). Those characteristics of a fixed annuity contract are relevant to whether the purchaser is likely to view it as primarily an investment. Finally, we note that respondents' source for the proposition that fixed annuities account for 75-80% of the contracts purchased cites that proportion as an "[h]istorica[l]" description of the market; in the same paragraph, it notes that variable annuity sales rose from $2.5 billion to $18 billion between 1980 and 1990, and predicts that "[a]s more and more potential investors learn about the benefits of variable annuities, the gulf between the dollars invested in fixed and variable annuities will narrow." D. Shapiro & T. Streiff, *Annuities* 50 (1992).

be required to "comply fully" with "any state laws" governing annuity sales.[3] 93-1612 Pet. App. 47a-48a.

Respondent's brief demonstrates, at most, that annuities have often been thought of as "insurance" products for some purposes, and that in their varying forms they manifest varying degrees of "insurance" characteristics. See, *e.g.*, Br. 18-25; *id.* at 31 n.14 (citing 4 L. Loss, *Securities Regulation* 2534 (Supp. ed. 1969) on the "continuous spectrum" of financial products "from pure insurance through pure investment"). That general proposition offers little guidance, however, for the proper treatment of modern annuity products as a matter of federal banking law. Specifically, respondent offers no reason to reject the Comptroller's fundamental point that the annuities that NationsBank would market, under the approval at issue here, are best characterized as investment products, not insurance policies. The Comptroller's judgments that NationsBank could undertake sales of those annuities in the course of its banking business, and that such annuities should not be classified as "insurance" for purposes of any negative implication that might be read into 12 U.S.C. 92, were well within the discretion afforded him in administering the national

[3] Although the issue is not presented in this case, we note the Comptroller's position that a State may not prohibit a national bank from engaging in activities it is permitted to conduct under federal law. That issue has arisen, for example, in the context of state restrictions on small-town insurance agency activities authorized by Section 92. See *e.g.*, *Owensboro Nat'l Bank* v. *Moore*, 803 F. Supp. 24 (E.D. Ky. 1992), appeals pending *sub nom. The Owensboro Nat'l Bank* v. *Stephens*, Nos. 92-6330 & 92-6331 (6th Cir.) (argued Sept. 29, 1994); *Barnett Banks of Marion County, N.A.* v. *Gallagher*, 839 F. Supp. 835 (M.D. Fla. 1993), appeal pending, No. 93-3508 (11th Cir.) (argued Sept. 19, 1994).

banking laws.[4] See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984).

3. Finally, respondent challenges (Br. 35-49) the Comptroller's conclusion that agency sales of annuity products can be part of or incidental to the "business of banking" within the meaning of 12 U.S.C. 24 Seventh. Respondent's conception of the scope of the banking power is, however, far too narrow. As we have shown (Gov't Br. 16-20), the powers conferred by Section 24 Seventh were intended to be interpreted broadly and pragmatically, and are not limited to only a few specified powers, or to only those powers exercised by banks in the mid-nineteenth century. The authorization to exercise "all such incidental powers as shall be necessary to carry on the business of banking," in the context of a statute that established a national banking system and created the office of the Comptroller to oversee it, must be understood to provide for change, growth, and expansion of the business of banking, under the Comptroller's supervision, to meet the needs of a changing national economy.[5]

[4] On respondent's persistent contention (see Br. 4-5, 16-17) that the Comptroller's decision in this case is not entitled to deference because it constitutes a "reversal of position" (Br. 17), see our opening brief at 38 n.19, and our reply brief at the petition stage at 3-5.

[5] Respondent contends (Br. 35) that Section 24 Seventh should be understood in the context of an historical "mistrust of the concentrated economic power of banks," exemplified in debates over the First and Second Banks of the United States. But the National Bank Act was passed in the course of financial convulsions caused by the need to finance the Civil War. The successful proponents of the Bank Act were animated, as a leading banking historian puts it, by a vigorous "nationalist enthusiasm." B.

Only a small portion of respondent's argument (Br. 45-48) addresses the Comptroller's actual position in this case: that because annuities of the sort that NationsBank would market today are essentially vehicles for investment, agency sales of those annuities fall within national banks' traditional power to help their customers buy and sell investment instruments. See Gov't Br. 20-22; 93-1612 Pet. App. 37a-41a. In disagreeing with that position, respondent relies on its interpretation of New York banking law as of 1838 (Br. 45-46), while dismissing as "unfathomable" (Br. 39 n.20) the authoritative construction of that law (on the precise question at issue here) by New York's highest court in 1994. Similarly, respondent implies (Br. 46) that banks had no power to broker securities for their customers before enactment of the McFadden Act in 1927, while offering neither citation nor response to this Court's prior statements to the contrary. See Gov't Br. 20-21, citing *Clarke* v. *Securities Indus. Ass'n*, 479 U.S. 388, 407-408 & nn.20-22 (1987), and *Securities Indus. Ass'n.* v. *Board of Governors*, 468 U.S. 207, 215 (1984). In any event, respondent cannot dispute that banks' general and incidental powers under Section 24 Seventh now plainly include the "business of dealing in securities and stock," which was specifically recognized by the Glass-Steagall Act in 1933.

Respondent argues (Br. 47-48) that agency sales of annuities cannot fall within banks' power to broker securities and other financial instruments, not only on the ground that annuity contracts are "insurance" for all purposes, but also because annuities are individual

---

Hammond, *Sovereignty and An Empty Purse: Banks and Politics in the Civil War* 334 (1970). It seems unlikely that they were gripped, at the same time, by what respondent calls "a mistrust of the concentrated economic power of banks."

contracts that are not traded in the financial markets. The power to act as a broker for securities and stock is not restricted, however, to items that are regularly traded on financial markets; it presumably includes various instruments that are illiquid and irregularly traded, such as stock and debt of privately-held corporations. There is no apparent reason why banks should not be able to undertake the same sort of non-recourse, no-risk intermediary sales with respect to annuity contracts.

Moreover, as we made clear in our opening brief (at 6-7, 32-35), annuities serve largely as vehicles for the tax-deferred investment and accumulation of capital. A typical variable annuity provides the purchaser with a wide variety of investment options during the accumulation phase, like those available from a family of mutual funds. Fee structures and tax penalties will generally provide substantial incentives to keep money invested within the annuity "wrapper" for a minimum period and until the purchaser has reached a certain age; but, subject to those potential expenses, the purchaser is usually entitled to the return of his investment upon demand. Within any given variable annuity, the premium investment is generally highly liquid, being easily moved from one type of investment to another, or into a cash-equivalent investment such as a money market fund. And during the accumulation phase of a variable annuity, the investor bears much or all of the risk associated with the investment of the premium. The fact that annuity contracts themselves are seldom traded is therefore irrelevant to the way annuities are marketed, the way they function, and the way they should be analyzed for purposes of this case. See, *e.g.*, *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 205-211 (1967), and *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959)

(characterizing variable annuities as investment securities for purposes of the federal securities laws).

The proper analysis is a functional one of the sort undertaken by the Comptroller in rendering his decision in this case. See 93-1612 Pet. App. 37a-41a. That analysis led the Comptroller to conclude that the annuities NationsBank seeks to market are sufficiently similar to other financial investments commonly brokered by national banks for their customers so that their sale is part of or incidental to the business of banking. That conclusion is a permissible construction of the national banking statutes committed by Congress to the Comptroller's administration. *Chevron*, 467 U.S. at 843.

* * * * *

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

OCTOBER 1994